Supreme Court, U.S.
FILED
APR 3 2002
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No. 01-1139

In The
Supreme Court of the United States

RICK'S AMUSEMENT, INC., et al.

Petitioners,

vs.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition For A Writ Of Certiorari
To the South Carolina Supreme Court

Respondent's Brief In Opposition to Petition for Writ of Certiorari

RONALD K. WRAY, II
Counsel of Record
Gallivan, White & Boyd, P.A.
330 E. Coffee Street
P.O. Box 10589
Greenville, S.C. 29603
(864) 271-9580

CHARLES M. CONDON
South Carolina Attorney General
NATHAN KAMINSKI, JR.
Senior Assistant Attorney General
Post Office Box 11549
Columbia, S. C. 29211
(803) 734-3736

QUESTIONS PRESENTED

South Carolina Code Ann. Section 12-21-2806 provided for a statewide referendum held during South Carolina's general elections in November 1994 that permitted the registered electors in each county in South Carolina to vote, and to determine by their vote, whether to terminate cash payouts for credits earned on coin-operated devices operated in the county. The question presented is whether the decision by voters in twelve of South Carolina's forty-six counties to terminate cash payouts on coin-operated devices constituted a taking of Petitioners' property for which just compensation is due under the United States Constitution or an unconstitutional impairment of Petitioners' contracts relating to the placement of coin-operated devices such as video poker machines in commercial establishments.

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OPINION BELOW

The opinion of the South Carolina Supreme Court (Pet. App. 1a-12a) is not yet officially reported.

JURISDICTION

The judgment of the South Carolina Supreme Court was entered on November 5, 2001. The jurisdiction of this Court is invoked by petitioners under 28 U.S.C. § 1257(a).

COUNTER STATEMENT OF THE CASE

These consolidated cases involve claims brought by several South Carolina corporations who were in some manner involved in the now-defunct video gambling industry in South Carolina. Petitioners comprise two groups of businesses: those who owned, maintained, repaired, or serviced video poker machines and those who owned or leased commercial establishments in which one or more such machines were placed pursuant to a contract with the machines' owners.

To understand the relevant background of this case, it is necessary to know something of the history of video poker in South Carolina. For nearly two centuries, slot machines and other forms of gambling have been illegal in South Carolina. These illegal gambling devices are subject to seizure and destruction. S.C. Code Ann. § 12-21-2712 (Supp. 2001).

In 1975, the South Carolina legislature added a provision to the state's anti-gambling laws that authorized the playing of "coin-operated nonpayout machines with a free play feature." 1975 S.C.

Act No. 237, Part II, § 4 (codified at S.C. Code § 16-19-60 (1976)). This provision was inserted without fanfare in the permanent provisions of the State appropriations act, and was not seen at the time as inaugurating widespread gambling in the State, since the language expressly continued the ban on "any machine which disburses money to the player." However, in 1991, the South Carolina Supreme Court construed this statute to mean that, while it was illegal for a video game *machine* itself to disburse money to a player, it was not illegal for a *person* (such as an arcade owner) to disburse money to a player as "payment" for the free plays that the player had won using such a machine. *See State v. Blackmon*, 403 S.E.2d 660, 662 (S.C. 1991) (per curiam).

In the interim, the General Assembly passed another provision in 1982 which expressly authorized, for the first time, the operation and possession of "video games with a free play feature." 1982 S.C. Act No. 466, Part II, § 14 (codified as amended at S.C. Code Ann. §12-21-2710 (Supp. 1999)). The South Carolina Supreme Court determined that this provision, when read in conjunction with S.C. Code § 16-19-60, insulated the video poker machines from seizure and destruction, to which they would otherwise have been subject. *See Powell v. Red Carpet Lounge*, 311 S.E.2d 719 (S.C. 1984).

In the wake of these rulings, video poker in South Carolina grew into a multi-billion dollar industry and became the subject of intense local debate. In a 1999 opinion, the Fourth Circuit Court of Appeals astutely observed that "[v]ideo poker has arguably been the most hotly contested issue in South Carolina in recent years." *See Johnson v. Collins Entertainment Co., Inc.*, 199 F.3d 710, 715 (4th Cir. 1999).

The industry was also the subject of extensive regulation. In determining that the federal courts should abstain from deciding the claims before it in *Johnson*, the Fourth Circuit noted that "South Carolina has employed a variety of legislative, administrative, and

judicial mechanisms to regulate this multi-billion dollar business. These mechanisms constitute an interdependent state network aimed at the comprehensive regulation of video poker." *Id.*

In 1993, the South Carolina General Assembly enacted legislation providing for a statewide referendum to permit the qualified electors of each county to vote and determine by their vote whether to terminate cash payouts for credits earned on coin-operated devices in their county. *See* S.C. Act No. 164, Part II, § 19H; S.C. Code Ann. § 12-21-2806 (Supp. 1995). It is this legislation which forms the basis of Petitioners' present claim. In the general election in November 1994, the majority of voters in twelve of South Carolina's forty-six counties chose to ban cash payouts for credits earned on coin-operated devices. Pursuant to the referendum, in those twelve counties it became unlawful after June 30, 1995 to use or possess a video game machine, as that term was defined in the statute, other than for purposes of storage, maintenance, or transportation. This prohibition remained in effect in those twelve counties from July 1, 1995 until November 4, 1996, when the South Carolina Supreme Court struck down this legislation as special legislation inconsistent with provisions in the state constitution requiring criminal laws to be uniform statewide. *See Martin v. Condon*, 478 S.E.2d 272 (S.C. 1996).

Following the issuance of the *Martin* decision, video poker returned for a time to the twelve counties that had voted to ban cash payouts. Ultimately, however, South Carolina banned video poker altogether. S.C. Code Ann. § 12-21-2710, as amended by 1999 S.C. Act 125, Part I, § 1 (effective July 1, 2000). Since July 1, 2000, video gambling machines are once again completely illegal in South Carolina. Under current law, it is illegal to possess or use these machines in the State. S.C. Code Ann. § 12-21-2710 (Supp. 2001). If found in the State, the machines are subject to seizure and destruction. S.C. Code Ann. § 12-21-2712 (Supp. 2001).

Not surprisingly, owners and lessees of video poker

machines challenged Act 125 on the grounds that it took their property without just compensation. The South Carolina Supreme Court held that Act 125 did not take the owners' video poker machines, their businesses, or the real property on which the businesses were located. *Westside Quik Shop, Inc. v. Stewart*, 534 S.E.2d 270 (S.C.), *cert. denied*, 531 U.S. 1029 (2000). This Court denied certiorari.

Meanwhile, Petitioners brought this suit seeking "to recover losses allegedly incurred by the local option law and the resulting cash payout ban." (Pet. App. 4a). Petitioners alleged that they signed contracts for placement of video poker machines in commercial establishments prior to the passage of the legislation permitting the referendum struck down in *Martin*. The State moved to dismiss Petitioners' claims for failure to state a claim on which relief can be granted under Rule 12(b)(6) of the South Carolina Rules of Civil Procedure. The trial court granted the State's motion to dismiss. (Pet. App. 13a-19a).

Both Petitioners and Respondent appealed the trial court's order. Petitioners, obviously, appealed the trial court's dismissal of their case. The State appealed those portions of the trial court's order that had denied some of the aspects of the State's motion to dismiss. However, because under South Carolina law rulings made by a trial court in denying a motion to dismiss are not "the law of the case" and the ruling does not preclude a party from raising the issue at a later point or points in the case, *see, e.g.*, *Hutley v. Young*, 462 S.C. 860 (S.C. 1995), the State later decided to withdraw its appeal.

The South Carolina Supreme Court affirmed the trial court's Order dismissing Petitioner's claims, relying heavily on its previous decision in a factually similar case. *See Mibbs v. Department of Revenue*, 524 S.E.2d 626 (S.C. 1999). The court first addressed Petitioners' takings claim. Petitioners claimed that "the invalid local option law 'revoked and/or impounded [their] contracts' for the placement of video gaming machines, thereby constituting a taking."

(Pet. App. 8a-9a). The court expressly "agree[d] with [Petitioners] that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment." (Pet. App. 8a). However, the court held that Petitioners' right to own or possess video gaming machines did not include any inherent "right" to continued cash payouts. (Pet. App. 9a). Rather, Petitioners' "rights to continued cash payouts were completely dependent upon regulatory licensing." *Id.*

The court next addressed Petitioners' claim that the local option law impaired their contracts. The court concluded that, given the climate in the State with respect to the legality of video poker, the ban on cash payouts could not have operated as a substantial impairment of the reasonable expectations of the contracting parties. The court stated that its decision was based upon the "unique environment" of regulation in South Carolina relating to video gambling, and would "not affect the certainty of contracts in highly regulated fields" like banking and insurance. (Pet. App. 11a). The court thus made clear that its decision was very specific to the video poker industry.

REASONS FOR DENYING THE WRIT

The decision of the South Carolina Supreme Court is correct and does not conflict with the decisions of this Court, any federal court of appeals, or any other state court of last resort. Moreover, this case involves an area of core state policy concern and does not present any issue of broad federal importance. Further review is therefore not warranted.

I

THIS CASE DOES NOT PRESENT ANY COMPELLING REASON TO GRANT A PETITION FOR WRIT OF CERTIORARI BECAUSE THERE IS NO IMPORTANT FEDERAL QUESTION DECIDED BELOW THAT CONFLICTS WITH RELEVANT DECISIONS OF THIS COURT, A UNITED STATES COURT OF APPEALS, OR ANOTHER STATE COURT OF LAST RESORT

The decision below does not conflict with any decision of this Court, a United States Court of Appeals, or another state court of last resort. Petitioners misstate the holding of the South Carolina Supreme Court and overstate the existence of an alleged "conflict" among courts in arguing that certiorari should be granted.

Petitioners assert that "courts are divided on whether businesses in highly regulated areas have the cognizable property interests required in takings and contract impairment cases." (Pet. 10). Neither the South Carolina Supreme Court nor any other court cited by Petitioners has held that businesses in highly regulated fields are categorically barred from asserting takings and contract impairment cases. On the contrary, in deciding the case below, the South Carolina Supreme Court expressly "agree[d] with [Petitioners] that a plaintiff who operates in an heavily regulated industry is not prohibited from establishing the existence of a property interest protected by the Fifth Amendment." (Pet. App. 8a). The court

emphatically did **not** hold that "a highly regulated industry has no cognizable property rights under the Takings and Contracts Clauses" as asserted by Petitioners. (Pet. 2). Rather, the court inquired into the nature of the property interest asserted by Petitioners and determined that whatever rights Petitioners had to own or possess video poker machines did not inherently include the right to make cash payouts to users of the machines. (Pet. App. 9a).

Moreover, lower courts are not divided on whether "a sweeping 'heavily-regulated industry' exception to cognizable property rights in takings claims" exists, as asserted by Petitioners. (Pet. 17). The opinions relied upon by Petitioners to demonstrate a conflict are fully consistent with one another and with the opinions of this Court, as discussed below.

In concluding as an initial matter that Petitioners had no "property right" to continue making cash payouts, the court below relied upon decisions of the Federal Claims Court and the Court of Appeals for the Federal Circuit. The Federal Circuit has adopted a two-tiered approach to determining whether a regulation constitutes a taking requiring just compensation. *See, e.g., M & J Coal v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir.), *cert. denied*, 516 U.S. 808 (1995). First, the court determines whether the plaintiff has a property interest within the meaning of the Fifth Amendment. *Id.* at 1154 (citing *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992)). Second, if a property interest is found, the court then determines whether the governmental action at issue constituted a compensable taking. *Id.* In making this determination, the court performs an *ad hoc* factual inquiry into "the character of the governmental action, the economic impact of the regulation on the claimant, and the extent to which the regulation has interfered with the claimant's distinct investment-backed expectations." *Id.* (citing *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)). The Federal Circuit and the Court of Claims have consistently employed this analysis in cases where the asserted "property right" is not traditionally recognized. *See, e.g., Allied*

General Nuclear Services v. United States, 839 F.2d 1572 (Fed. Cir.), *cert. denied*, 488 U.S. 819 (1988) (corporation's expectation of being awarded a license to operate a nuclear power reprocessing plant was not a property right protected by Fifth Amendment); *Mitchell Arms v. United States*, 7 F.3d 212 (Fed. Cir. 1993), *cert. denied*, 511 U.S. 1106 (1994) (expectation of selling assault rifles in domestic commerce was not a right inherent in ownership of rifles but was totally dependent upon import permits); *Conti v. United States*, 48 Fed. Cl. 532 (2001) (federal swordfish fishing permit does not confer a compensable property right in continued use of prohibited gillnet gear).

Petitioners repeatedly use terms such as "subvert," "repudiate," "side-step," "circumvent," "avoid," and "short-circuit," to describe this line of decisions with respect to this Court's takings jurisprudence. (Pet. 10, 11, 12, 19, 21). On the contrary, as discussed more fully below, the approach employed by these courts is fully consistent with the precedents of this Court, which have always necessarily required that a property owner actually own the property interest allegedly proscribed. *See, e.g., Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1000-04 (1984) (first step in analysis is to determine whether Monsanto has a property interest in the data submitted to the EPA); *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 55 (1986) ("[T]he 'contractual right' at issue in this case bears little, if any, resemblance to rights held to constitute 'property' within the meaning of the Fifth Amendment."). In *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027 (1992), this Court held that even restrictions on the use of land, which are traditionally viewed much more critically than restrictions on personal property, require a "logically antecedent inquiry into the nature of the owner's estate" to determine whether "the proscribed use interests were . . . part of his title to begin with." In some respects, this "logically antecedent inquiry" (hence the "two-tiered" approach of the claims courts) is analogous to the question of standing: obviously, the government

cannot "take" something that the citizen does not own.

This Court has repeatedly declined opportunities to review these federal decisions applying a two-tiered analysis to takings claims. *See, e.g., M & J Coal v. United States*, 47 F.3d 1148, 1153-54 (Fed. Cir.), *cert. denied,* 516 U.S. 808 (1995); *Mitchell Arms v. United States*, 7 F.3d 212 (Fed. Cir. 1993), *cert. denied*, 511 U.S 1106 (1994); *Allied General Nuclear Services v. United States*, 839 F.2d 1572 (Fed. Cir.), *cert. denied,* 488 U.S. 819 (1988). Respondent does not suggest that these denials of certiorari have precedential import. Rather, Respondent suggests that any alleged error in the federal claims courts' analysis would be more appropriately corrected by review of one of these federal decisions, rather than through a state case involving an area of core state policy concern such as the instant case.

In any event, Petitioners have not demonstrated that the decision below conflicts with a decision of another state court of last resort, a United States Court of Appeals, or this Court on an important federal question. Petitioners instead rely upon assertions of a generalized conflict among courts as to the legitimacy of the two-tiered approach to takings cases. In support of their position that a conflict exists which requires resolution by this Court, Petitioners rely almost exclusively on *Maritrans, Inc. v. United States*, 40 Fed. Cl. 790 (1998). *Maritrans* is an inappropriate vehicle to demonstrate a conflict because it is not a decision of a United States Court of Appeals so as to implicate Supreme Court Rule 10.

Moreover, *Maritrans* is not in conflict with the decisions of other courts, including that of the South Carolina Supreme Court in the instant case. In *Maritrans*, the owners of single-hulled tank barges sued the United States alleging that the Oil Pollution Act of 1990 effected a taking of their property without just compensation by requiring that all single-hulled vessels be retrofitted with double hulls. The court uncritically applied the

two-tiered approach adopted by the Federal Circuit. *Id.* at 793. The government did apparently propound the "theory that the regulated nature of the industry precludes a cognizable Fifth Amendment property interest." *Id.* at 797. However, the court properly rejected that theory as inconsistent with prior decisions of this Court and of the Federal Circuit and Court of Claims, including *Mitchell Arms*, with which Petitioners assert *Maritrans* conflicts. The *Maritrans* court applied the two-tiered analysis and concluded, under the first tier, that "[i]nherent in the ownership of the vessels is the right to use them." *Id.* at 799. The court distinguished *Mitchell Arms* and *Allied General* on their facts. *Id.* at 795-96. Having found a cognizable property interest, the court proceeded in subsequent opinions to address the *Penn Central* factors, ultimately concluding that the government had not taken plaintiff's property. *Maritrans v. United States*, 51 Fed. Cl. 277 (2001).

Other cases relied upon by Petitioners to support their assertion of a conflict include *Golden Pacific Bancorp v. United States*, 15 F.3d 1066 (Fed. Cir.), *cert. denied*, 516 U.S. 961 (1994) and *United Nuclear Corp. v. United States*, 912 F.2d 1432 (Fed. Cir. 1990). These decisions are not evidence of a conflict among courts since they were decided by the same court with which they supposedly conflict – the Court of Appeals for the Federal Circuit. In any event, these decisions, like *Maritrans*, are fully consistent with the present case. In *Golden Pacific*, the court held that the Controller's actions of declaring the bank insolvent and placing it in FDIC receivership did not constitute a compensable taking under the Fifth Amendment. The court concluded Golden Pacific's ownership of the bank did not include "*either* the historically rooted expectation of compensation *or* the reasonable investment-backed expectation necessary to support a Fifth Amendment taking claim." 15 F.3d at 1076 (emphasis added). In *United Nuclear*, the court found a Fifth Amendment taking in an agency action dispossessing the claimant's leasehold interest in Indian lands. *United Nuclear* was fundamentally

different from the instant case – and from *Mitchell Arms*, *Allied General*, etc. – in that the property interest taken was a leasehold interest in real property. 912 F.2d at 1437.

Petitioners also cite *Woodland Manor III Associates v. McLeod*, 2000 WL 276820, *5 (R.I. Super. Mar. 2, 2000), as evidence of a conflict requiring this Court to grant certiorari. *Woodland Manor* is not a decision of a state court of last resort, and is thus irrelevant to the existence of a conflict under this Court's rules. U.S. S. Ct. R. 10. In any event, the Rhode Island Supreme Court has remanded that case to the lower court for reconsideration in light of *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001).

Finally, in *Colorado Dep't of Health v. The Mill*, 887 P.2d 993, 1002 (Colo. 1995), *cert. denied*, 515 U.S. 1159 (1995), cited at Pet. 16 and 19, the court found no taking because the challenged regulation merely implemented restrictions on land use that inhered in the plaintiff's title under the Colorado common law of nuisance. The opinion does not address the validity of the two-tiered approach.

Petitioners do not establish the existence of any conflict between the decision below, on the one hand, and those of any lower federal court or other state court of last resort, on the other hand, that would warrant this Court's review. Even assuming a generalized conflict among courts – which Respondent respectfully submits does not exist – Petitioners have not established that the court below decided an important federal question in the present case in a way that conflicts with the decision of another state court of last resort, a United States Court of Appeals, or this Court.

II

THE SOUTH CAROLINA SUPREME COURT CORRECTLY DETERMINED THAT THE BAN ON VIDEO POKER CASH PAYOUTS DID NOT CONSTITUTE A TAKING OF PETITIONERS' PROPERTY OR AN UNCONSTITUTIONAL IMPAIRMENT OF PETITIONERS' CONTRACTS

A. The Court Below Correctly Determined that the Ban on Video Poker Cash Payouts Did Not Take Petitioners' Property.

Petitioners claim that the sixteen-month ban on cash payouts in twelve South Carolina counties caused a taking of their property without just compensation. The court below correctly rejected that claim because no "property" belonging to Petitioners was "taken." Petitioners' attempt to characterize the statute at issue as an unconstitutional regulation of property is unavailing. Clearly, the statute at issue was merely a police power prohibition on gambling activities that cannot support a takings claim.

The Takings Clause of the Fifth Amendment provides: "[N]or shall private property be taken for public use without just compensation." U.S. Const. Amend. V. This provision is made applicable to the states through the Fourteenth Amendment. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 499 U.S. 155, 160 (1980).

First, as to the existence of "property," the State has never contended that the mere fact of heavy regulation, in and of itself, would preclude in all cases a finding that a property interest exists. However, a court cannot logically determine whether property has been taken without identifying the property allegedly taken. The Fifth Amendment concerns itself solely with "property," *i.e.*, with the owner's relation as such to the physical thing and not

with other collateral interests which may be incident to ownership. *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945). A collateral interest has been defined as a right not inherent in the ownership of the physical property. *Mitchell Arms v. United States*, 7 F.3d 212, 217 (Fed. Cir. 1993), *cert. denied*, 511 U.S. 1106 (1994).

Petitioners acknowledge that "it appears unquestioned that property rights dependent on an Act of Congress are subject to later amendments of the relevant statutory scheme." (Pet. for Cert. p. 15) (citing *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 55 (1986)); *see also Connolly v. Pension Benefit Guarantee Corp.*, 475 U.S. 211 (1986) ("Contracts may create rights of property, but when contracts deal with a subject matter which lies within the control of Congress, they have a congenital infirmity.") (quoting *Norman v. Baltimore & Ohio R. Co.*, 294 U.S. 240, 307-08 (1935)). Likewise, a "right," such as it is, created solely by the State's issuance of a license pursuant to a statutory scheme is subject to the State's power to alter the relevant statutory scheme. *See id.*

Mitchell Arms is highly analogous to the present case. The plaintiff in that case was a federally-licensed firearms importer who claimed a taking when the Bureau of Alcohol, Tobacco and Firearms banned the style of weapons that the plaintiff had imported. *Id.* at 213-214. The Federal Circuit rejected plaintiff's argument that because it had import permits to import the guns, it had a protected property interest that could not be taken away without just compensation. *Id.* at 215-16.

Like *Mitchell Arms*, the present case involves an area of key government concern and control. Constitutional and statutory prohibitions on gambling have deep historical roots and are unquestionably valid. As noted by this Court in *Ah Sin v. Wittman*, 198 U.S. 500, 505-06 (1905): "The suppression of gambling is concededly within the police powers of a state, and legislation prohibiting it, or acts which may tend to or facilitate it,

will not be interfered with by the court unless such legislation be a clear, unmistakable infringement of rights secured by the fundamental law." (internal quotations omitted).

Moreover, Petitioners' argument that the State "revoked and/or impounded their contracts" for the placement of video poker machines in commercial establishments, constituting a compensable taking (Pet. 4), is misplaced. As Petitioners acknowledge, this case involves no regulation of real property, nor any physical confiscation of personal property. On the contrary, the State merely permitted the voters of each county to determine whether to permit cash payouts to players of video poker machines. The effect of the law was not to "take property," but to prohibit certain gambling activities. As this Court has previously held, Petitioners cannot create a property interest, and manufacture a takings claim, by making a contract relating to activities that are well within the State's power to prohibit. *See Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them."). In short, the state took nothing belonging to Petitioners.

Petitioners acknowledge that "in certain situations, it may be required for a court to analytically split the question of a claimant's cognizable property interests from the wider context of the impact of regulation on those rights, the claimant's investment-backed expectations, and the character of the governmental action." (Pet. 13). However, Petitioners assert, "the South Carolina Supreme Court's decision purports to allow this deflection from the *Penn Central* analysis in most, if not all, circumstances." (Pet. 13). This contention completely mischaracterizes the South Carolina Supreme Court's holding, which was very fact specific and clearly addressed to the now-illegal video gambling industry. (Pet. App. 11a).

Moreover, the South Carolina Supreme Court's opinion is consistent with the *Penn Central* analysis. In determining whether a taking has occurred, this Court has outlined three factors that must be considered. The three factors are (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of governmental action. *Penn Central*, 438 U.S. at 124. Considering these factors in reverse order, this Court has previously noted that the "nature of the government action is the critical factor in a takings analysis." *Keystone Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987).

The character of the governmental action here is a classic exercise of the police power. In *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211 (1986), the plaintiffs argued that Congress' enactment of a regulatory scheme affecting the plaintiffs' pension fund resulted in a taking requiring just compensation. Rejecting this contention, this Court noted that the government interference with the contract at issue "arises from a program that adjusts the benefits and burdens of economic life to promote the common good, and under our cases, does not constitute a taking requiring government compensation." *Id.* at 224. The Court stressed that the United States had "taken nothing for its own use, and only has nullified a contractual provision limiting liability by imposing an additional obligation that is otherwise within the power of Congress to impose." *Id.* The Court noted that "the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking." *Id.*; *see also Mugler v. Kansas*, 123 U.S. 623 (1887) (no taking even though the state passed legislation that prohibited the plaintiff from engaging in a business that had been established before the law was passed).

Likewise, the character of the governmental action in the instant case is completely consistent with the exercise of the

State's police powers. The State took nothing for its own use, but merely authorized the electors in each county in South Carolina to decide whether to restrict gambling activities within the county, an action unquestionably within the State's police power.

The next factor for consideration is the economic impact of the regulation. The only economic impact of the complained of regulation on Petitioners was lost business profits. As this Court emphasized in *Andrus v. Allard*, 444 U.S. 51, 66 (1979), "loss of future profits – unaccompanied by any physical property restriction – provides a slender reed upon which to rest a takings claim." In *Andrus*, this Court held no taking occurred when Congress passed the Eagle Protection Act, which prohibited commercial transactions in parts of birds protected by the Act. The court noted that "the interest in anticipated gains has traditionally been viewed as less compelling than other property-related interests." *Id.* Moreover, any alleged diminution in the value of Petitioner's property would not constitute a taking. *See Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California*, 508 U.S. 602, 646 (1993) ("our cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking"); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922) ("Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

The final factor to be considered is the extent to which the regulation has interfered with reasonable investment-backed expectations of the parties. The extent and degree of regulation is particularly relevant to this inquiry. *See Connolly*, 475 U.S. at 227 ("Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.").

The State's position is even stronger – and Petitioner's position concomitantly weaker – where, as here, the personal property at issue is the subject of unquestionable government control. As noted, courts have repeatedly held that the State has a legitimate interest in controlling gambling activities. Given the State's historical high degree of control over gambling, Petitioners could have no reasonable expectation that cash payouts would continue to be legal. Any investments made in the expectation of the continued legality of such payouts were purely speculative.

Additionally, Petitioners inaccurately characterize the ban on cash payouts as a "total ban on their business activities from July 1995 to November 1996." (Pet. 4). Presumably, Petitioners mean by this to invoke the *per se* doctrine of *Lucas* which arises when a regulation deprives an owner of all economically beneficial use of his property. *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). Significantly, however, Petitioners' video poker machines were not confiscated, Petitioners could still sell those machines or use them in the thirty-four counties in the state in which cash payouts remained legal, and Petitioners could have avoided the alleged forfeiture of their machines by disposing of their property prior to the date the ban on cash payouts was to take effect. *See Hamilton v. Kentucky Distilleries & Warehouse Co.*, 251 U.S. 146 (1919) (rejecting takings claim involving wartime restriction on domestic sale of liquor that had delayed effective date, which gave distilleries seven months to sell their liquor without restrictions).

With respect to the Petitioners who are alleged owners and/or operators of commercial establishments, these Petitioners could continue to use their businesses and the real property on which those businesses stood for any legal purpose. Moreover, Petitioners' contracts to place video poker machines in their establishments in these counties were contracts relating to "pure contraband" – "objects the possession of which, without more,

constitutes a crime." *Bennis v. Michigan*, 516 U.S. 442, 459 (1996) (Stevens, J., dissenting). Indeed, these gambling devices fall squarely within the types of property that have traditionally been classified as contraband subject to forfeiture. *See, e.g., Lawton v. Steele*, 152 U.S. 133, 136, 142 (1894) (treating "articles used for gambling purposes" as traditionally within a state's power to forfeit). As noted above, Petitioners cannot create a takings claim simply by making a contract relating to these devices. *Hudson Water Co.*, 209 U.S. at 357; *see also Lucas*, 505 U.S. at 1027-28 ("[I]n the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [a property owner] ought to be aware of the possibility that new regulation might even render his property commercially worthless (at least if the property's only commercially productive use is sale or manufacture for sale).") (citing *Andrus v. Allard*, 444 U.S. 51 (1979)).

Finally, the South Carolina Supreme Court's determination in *Martin* that the referendum on cash payouts violated South Carolina's constitution because the prohibition on cash payouts did not apply statewide is of no import in considering Petitioners' claims. Petitioners cite no authority for the proposition that the subsequent declaration of the statute's unconstitutionality results, necessarily, in a finding that a taking or impairment of contract occurred. Clearly, this suggested result is not advisable. As noted by one state Supreme Court, "[f]or a court to hold a state liable for unconstitutional legislation would introduce a profound conservative tilt into the lawmaking process. Legislators would become reluctant to legislate, knowing that money damages were at stake if a court ultimately disagrees with their appraisal of the constitutionality of a bill." *Vest v. Shafer*, 757 P.2d 588 (Alaska 1988), *cert. denied*, 491 U.S. 904 (1989).

This is particularly true where, as here, Petitioners conceded before the South Carolina Supreme Court that the State could (as it ultimately did) completely ban the video gaming

industry and no compensation would be due. (Pet. App. 10a n. 4). *See Westside Quik Shop, Inc. v. Stewart*, 534 S.E.2d 270 (S.C.) *cert. denied*, 531 U.S. 1029 (2000). It would be strange indeed to permit Petitioners to pursue claims for damages in this case simply because the method chosen by the General Assembly was held to be invalid under State law, for reasons completely unrelated to the law's substantive validity, when Petitioners acknowledge that had the ban on cash payouts been applied statewide they would have no basis for any claim.

Accordingly, Petitioners have not established their entitlement to compensation under any theory. Moreover, even if this Court disapproves of the two-tiered analysis of the federal claims courts, followed by the South Carolina Supreme Court in this case, the Court should nevertheless deny the petition for certiorari. Because of the nature of the purported property interest involved in this case, and the strong State interest in controlling gambling activities, this case presents a poor vehicle for the correction of any asserted analytical errors on the part of courts adjudicating takings claims.

B. The Court Below Correctly Determined that the Ban on Video Poker Cash Payouts Did Not Unconstitutionally Impair Petitioners' Contracts.

The Contracts Clause of Art. I, § 10, provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." Despite the unequivocal language of this passage, "it is well settled that the prohibition against impairing the obligation of contracts is not to be read literally." *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502 (1987). "The Contract Clause does not deprive States of their broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed, as a result." *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983). Instead, the Constitutional prohibition on impairment of the obligations of

contracts "must be accommodated to the inherent police power of the State to safeguard the vital interests of its people." *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 410 (1983) (citing *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 434 (1934)). In determining whether a statute violates the Contracts Clause, this Court "balance[s] the language of the Contract Clause against the State's interest in exercising its police power." *Energy Reserves Group*, 459 U.S. at 410.

The threshold inquiry is whether the state law has, in fact, operated as a substantial impairment of a contractual relationship. *Id.* at 411. An important consideration in determining the extent of the impairment is whether the affected industry has been regulated in the past. *Id.; see also Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38 (1940) ("When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic."). If the regulation at issue is found to constitute a substantial impairment, "the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem." *Id.* at 411-12 (internal citations omitted). This requirement "guarantees that the State is exercising its police power, rather than providing a benefit to special interests." *Id.* at 412.

Finally, assuming a significant and legitimate public purpose has been identified, "the next inquiry is whether the adjustment of the rights and responsibilities of contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption." *Id.* at 412 (internal quotations omitted). "Unless the State itself is a contracting party, as is customary in reviewing economic and social regulation, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *Id.* at 412-13 (internal quotations and

citations omitted).

In *Energy Reserves Group*, this Court held that a natural gas supplier's intrastate contracts with public utilities, containing governmental price escalator and price redetermination clauses, were not impaired, in violation of the contract clause, by a Kansas statute which prohibited consideration either of ceiling prices set by federal authorities or of prices paid in Kansas under other contracts in application of indefinite price escalators. In determining the statute did not unconstitutionally impair the contracts, the Court placed great emphasis on the state's "extensive and intrusive" regulation of the natural gas industry. *Id.* at 413-14. Because price regulation was foreseeable, the Act did not impair the plaintiff's reasonable expectations and therefore did not operate as a substantial impairment of its contracts. *Id.* at 414. The Court reached this result despite the fact that Kansas had not previously regulated natural gas prices specifically. *Id.* at 413.

As in *Energy Reserves Group*, and perhaps even more so, the contracts at issue in the present case involve an area that has historically been the subject of vast state control. Like this Court in *Energy Reserves Group*, the South Carolina Supreme Court, relying on its earlier decision in *Mibbs v. South Carolina Dep't of Revenue*, 524 S.E.2d 626 (S.C. 1999), determined the ban on cash payouts for video poker did not operate as a substantial impairment of the parties' contracts for placement of video poker machines. Not only was the video poker industry the subject of extensive regulation, but the parties entered into their contracts in a period during which "lawmakers repeatedly introduced legislation specifically aimed at eliminating nonmachine cash payouts." (Pet. App. 11a). Given this "unique environment," Petitioners could not expect to insulate themselves against such legislation by making contracts relating to video poker machines. *See Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state

restriction, cannot remove them from the power of the State by making a contract about them."); *see also Beer Co. v. Massachusetts*, 97 U.S. 25 (1878) (state prohibition laws may be applied to contracts for the sale of beer and wine that were valid when entered into); *Stone v. Mississippi*, 101 U.S. 814 (1879) (the state may pass a law barring lotteries and apply that law to lottery tickets that were valid when issued).

Petitioners assert that the court below erred in considering only the first step in the Contracts Clause analysis. (Pet. 24). The State respectfully submits that, on the contrary, if a regulation does not substantially impair a contract, there is no reason for further analysis. However, assuming for purposes of argument that the lower court should have examined the remaining factors, it is clear that Petitioners' claim would fail under them as well. The State unquestionably has a significant and legitimate public purpose in regulating – or even prohibiting – gambling activities. *See, e.g., Stone*, 101 U.S. at 818 ("If lotteries are to be tolerated at all, it is no doubt better that they should be regulated by law, so that the people may be protected as far as possible against the inherent vices of the system."). Moreover, the ban on cash payouts was "based upon reasonable conditions" and was "of a character appropriate to the public purpose justifying the legislation's adoption." *Energy Reserves Group*, 459 U.S. at 412. The legislation at issue merely allowed counties to permit or prohibit cash payouts to players of video poker machines. This minimal restriction was certainly reasonable and appropriate to the State's purpose of restricting gambling activities in the State, and therefore does not constitute a violation of the Contracts Clause under this Court's precedents.

CONCLUSION

Respondent submits that Petitioners have framed a question to this Court that does not require an answer. The State of South Carolina does not contend, and its Supreme Court has

not held, that businesses operating in highly regulated fields are categorically barred from establishing takings claims. The court below correctly applied well-settled precedents of this Court to conclude that Petitioners did not establish a taking of property requiring just compensation or an unconstitutional impairment of their contracts. Moreover, this case does not present an appropriate case for this Court's review because it concerns an area of core state policy concern, rather than a broadly applicable federal question. Further, Petitioners have not established the existence of a conflict among courts requiring resolution. It is therefore respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

RONALD K. WRAY, II
Counsel of Record
Gallivan, White & Boyd, P.A.
330 E. Coffee Street
P.O. Box 10589
Greenville, S.C. 29603
(864) 271-9580

CHARLES M. CONDON
South Carolina Attorney General
NATHAN KAMINSKI, JR.
Senior Assistant Attorney General
Office of the South Carolina
Attorney General
Post Office Box 11549
Columbia, S. C. 29211
(803) 734-3736

April 3. 2002